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Notes

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Following the financial crises of 2008, the Dodd-Frank Act was signed into law to protect consumers from abusive financial services among other things. However, the Dodd-Frank Act has a non-retroactive effect on predatory lending practices that occurred before its enactment. Therefore, many consumers who entered into abusive contracts are not able to seek relief through the Dodd-Frank Act. With the recent Second Circuit decision Madden v. Midland Funding LLC, consumers are now able to contest these contracts through the exercise of their state usury laws.

This Note suggests that the remaining circuit courts should begin to follow the Second Circuit Madden decision in the interest of consumer protection. This Note also proposes that in the event the Supreme Court grants certiorari to resolve the existing circuit splits, the Second Circuit's decision in Madden should be upheld.

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INTRODUCTION

Predatory lending is pervasive in American markets. The Federal Deposit Insurance Corporation ("FDIC") describes predatory lending as "imposing unfair and abusive loan terms on borrowers."[1] Not only does predatory lending "[d]estabilize[] and [e]rode[] [the much-needed] [t]rust in the [f]inancial [s]ystem," it also consumes the wealth of families, takes away the rights of ownership, and tarnishes the highly sought after American Dream.[2] Despite the government's attempt to stop these unfair lending practices through the passage of new regulations, non-national bank entities continue to have the authority to charge higher interest rates than what state law permits.[3]

The absence of legal recourse for consumers has sparked heated debate across the nation and has left many consumers questioning the

1. OFF. OF THE INSPECTOR GENERAL, REP. NO. 06-011, CHALLENGES AND FDIC EFFORTS RELATED TO PREDATORY LENDING (2006).

2. SARAH D. WOLFF, CTR. FOR RESPONSIBLE LENDING, THE CUMULATIVE COSTS OF PREDATORY PRACTICES: THE STATE OF LENDING IN AMERICA & ITS IMPACT ON U.S. HOUSEHOLDS 17 (2015); Rebecca McCray, *How Racially Driven Predatory Lending Hurts Us All*, TAKEPART (June 16, 2015), http://www.takepart.com/article/2015/06/16/how-racially-driven-predatory-lending-hurts-us-all.

3. *See, e.g.*, Krispin v. May Dep't. Stores, 218 F.3d 919 (8th Cir. 2000); Phipps v. FDIC, 417 F.3d 1006 (8th Cir. 2005); FDIC v. Lattimore Land Corp., 656 F.2d 139 (5th Cir. 1981); Olvera v. Blitt & Gaines, P.C., 431 F.3d 285 (7th Cir. 2005).

integrity of federal laws, which trump state consumer laws.[4] With the Second Circuit's recent decision in *Madden v. Midland Funding, LLC*, consumers taken advantage of during the financial crisis are now able to combat abusive contracts without having to rely on the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[5] However, shortly after the *Madden* decision, the defendant, Midland Funding, LLC, filed a petition for certiorari to the Supreme Court of the United States.[6] Although the Supreme Court denied certiorari and failed to provide clarity pertaining to the existing circuit splits, the Second Circuit ruled in favor of the plaintiff and held that non-national bank entities were not allowed to charge interest rates higher than what state laws permits.[7] Since circuit court decisions are merely persuasive and not binding authority on other circuit courts, the effect of *Madden* has yet to be realized by the lending market.[8]

Currently, the law in the Second Circuit favors consumers.[9] If the Supreme Court were to reverse the Second Circuit's decision in *Madden*, then once again the law will be in favor of non-national bank entities. If the Court allowed non-national bank entities to continue to enjoy immunity from the National Bank Act, which exclusively applies to nationally chartered banks, not only will these entities continue to evade criminal and civil liability, but many consumers will be left without sufficient legal recourse.

Accordingly, in the interest of consumer protection, this Note suggests that other circuits should follow the Second Circuit *Madden* decision. In the event the Supreme Court grants certiorari in order to provide reliable guidance to financial institutions and resolve the existing circuit splits, the Second Circuit's decision in *Madden* should be upheld.

This Note first examines predatory lending in the many forms in which it can arise. Second, this Note discusses how predatory lending causes prejudicial consequences for many consumers. Third, this Note identifies the steps that the government has taken to combat these practices through newly enacted laws and regulations. Fourth, this Note provides an in-depth discussion on the National Bank Act of 1964. Over the years, this Act has given nationally chartered banks the ability to preempt state consumer usury laws and given non-national bank entities

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4. Madden v. Midland Funding, LLC, 786 F.3d 246, 250 (2d Cir. 2015) (citing Beneficial Nat'l Bank v. Anderson, 539 U.S. 1, 11(2003)) (under the National Bank Act "there is no such thing as a state-law claim of usury against a national bank.").

5. *See Madden*, 786 F.3d 246.

6. Sean Murray, *Madden v. Midland Appealed to the US Supreme Court*, DEBANKED (Nov.15 2015), http://debanked.com/2015/11/madden-v-midland-appealed-to-the-us-supreme-court/.

7. *See Madden*, 786 F.3d at 250.

8. Barbara A. Bintliff, *Mandatory v. Persuasive Cases*, 9 PERSPECTIVES: TEACHING LEGAL RESEARCH AND WRITING 83, 84 (2001).

9. *See generally Madden*, 786 F.3d 246.

the same type of preemptive protections prior to the passage of the Dodd-Frank Act. Fifth, this Note provides a case analysis of the *Madden* decision and how such case law is combating predatory practices. Sixth, this Note identifies the existing relevant circuit splits. Finally, this Note concludes by suggesting that consumers' rights can still be salvaged if the judicial branch takes the proper steps moving forward.

I. Background: Context, In-Depth Discussion On Predatory Lending

A. Predatory Lending's Raw State of Mind

Predatory lending arises in many forms. Often times, it consists of "unconscionable lending practices where a borrower is provided with an unfair loan."[10] Predatory lending encompasses practices that encourage borrowers to agree to loans that are prejudicial, often times achieved "through outright deception, or through aggressive sales tactics, taking advantage of borrowers' lack of understanding of extremely complicated transactions" in such a manner that makes it difficult for a consumer to defend against.[11] The most common forms of predatory lending arise in mortgage loans, payday loans, and credit cards.[12]

With regard to mortgage loans, it is estimated that annually "12 million Americans spend $17 billion on payday loans, despite the fact research has shown these costly lines of credit often leave borrowers worse off" overall, and "U.S. borrowers lose 9.1 billion annually to predatory lending practices."[13] Industry groups contend that excessive penalty fees and interest rates are treated as risk-management tools.[14] However, these risk management tools do not justify the relationship between predatory practices and sudden increase in losses, in large part

10. Amy Loftsgordon, *Predatory Lending Practices and Foreclosure Laws*, AllLaw, http://www.alllaw.com/articles/nolo/foreclosure/predatory-lending-practices.html (last visited Aug. 6, 2017).

11. *Predatory Lending*, InvestorDictionary.com, http://www.investordictionary.com/definition/predatory-lending (last visited Aug. 6, 2017).

12. *See generally* Eric Stein, Coalition for Responsible Lending, Quantifying the Economic Cost of Predatory Lending (2001) (arguing that U.S. borrowers lose $9.1 billion annually to predatory home lending practices); Joshua M. Frank, Ctr. for Responsible Lending, Predatory Credit Card Lending: Unsafe, Unsound for Consumers *and* Companies (2012) (discussing the prevalent marketing and pricing practices in the credit card industry before the implementation of the Credit Card Accountability, Responsibility and Disclosure Act of 2009); *see also* Brian Dakss, *Loans to Avoid at All Costs*, CBS News (Mar. 6, 2007, 11:25 am), http://www.cbsnews.com/news/loans-to-avoid-at-all-costs/.

13. Ashlee Kieler, *Abusive Lending Practices Can Lead to Negative Long-Term Consequences for Borrowers, Communities*, Consumerist (June 16, 2015, 9:00 AM), https://consumerist.com/2015/06/16/abusive-lending-practices-can-lead-to-negative-long-term-consequences-for-borrowers-communities/; Stein, *supra* note 12, at 2.

14. Frank, *supra* note 12, at 13.

because these outrageous fees do not help to undercut risks.[15] Instead, they largely contribute to the increase in risk.[16] Indeed, research shows that firms utilized these coercive and unfair lending practices in order to make it difficult for consumers to understand the contract terms in hopes of maximizing profits.[17] However, only changes to federal and state laws will have any significant impact on these practices. [18] What is now evident is that today's consumers live in an age where "the most important lending issue today is no longer the denial of credit, but rather the terms of credit."[19]

B. Predatory Lending Affects Low Income Families, Minorities and Military Members, Which in Turn Affects the Overall Financial Market.

The Cumulative Costs of Predatory Practices, a report by the Coalition for Responsible Lending, indicates that low-income consumers and consumers of color were the groups who suffered most from unfavorable loan terms.[20] Low-income families that make an average annual income between $25,000 and $35,000 were more susceptible to receiving abusive loan terms.[21] Unfortunately, this greatly affected African American and Latino communities.[22] Studies show that borrowers of color are two-to-three times more likely to receive abusive loans when compared to Caucasian borrowers.[23] This discrepancy plays a fundamental role in widening the wealth gap between white families and minority families.[24] Moreover, "[h]igh levels of debt make it difficult for people to purchase cars and homes, invest in education, put away money for retirement, and, in some cases, get a job."[25] The rippling effect of this reality, in turn, causes the economy as a whole to suffer.[26]

Members of the armed forces are also being victimized by these practices—a proposition difficult to fathom in light of the Military Lending Act, which provides members of the military protection in consumer credit transactions.[27] Since its enactment, government

15. *Id.*
16. *Id.*
17. *Id.* at 4.
18. Stein, *supra* note 12, at 2.
19. *Id.*
20. Kieler, *supra* note 13.
21. *Id.*
22. McCray, *supra* note 2.
23. Kieler, *supra* note 13.
24. *Id.*
25. McCray, *supra* note 2.
26. *Id.*
27. FDIC, FIL-37-2015, Final Rule: Military Lending Act (Sept. 8 2015), https://www.fdic.gov/news/news/financial/2015/fil15037.html.

authorities have come to recognize that the Military Lending Act has its deficiencies.[28] These deficiencies, officials say, threaten to leave thousands of military members throughout the nation susceptible to potential predatory loans by retailers, dealerships, and other credit pitched mechanisms.[29] Authorities further note that the newly enacted laws have not kept pace with predatory lenders that prey on servicemen.[30] Though defaulting on loans can lead service members into foreclosure, which in turn is detrimental to their financial stability, what is most concerning is that service members who are unable to control their debt are more likely to undertake financial inducements to commit espionage.[31] This can have the detrimental effect of threatening national security on a broader scale.[32]

With these abusive practices affecting a large number of American citizens, distrust in the financial system is inevitable. These practices generate economic outcomes that hurt the nation's financial markets as a whole. Sarah Bloom Raskin, a member of the Federal Reserve Board, attributes much of the public's current lack of trust in the financial system to banks' "unfair and deceptive lending practices of the past."[33] Consequently, the economic system suffers, which ultimately leads to higher losses and lower levels of economic participation.[34]

C. The Government's Attempt to Combat Predatory Practices

The executive and legislative branches of government began to divert more attention and resources to our nation's broken financial regulatory system following the financial crisis of 2008.[35] In 2010, in an attempt to protect families from unfair abusive practices, the Obama Administration signed into law the Dodd-Frank Act in hopes of curing the lack of oversight in the nation's financial system.[36] The Dodd-Frank Act provides efficient consumer safeguards to prevent the exploitation of borrowers by imposing more federal regulations on financial

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28. Jessica Silver-Greenberg & Peter Eavis, *Service Members Left Vulnerable to Payday Loans*, N.Y. Times (Nov. 21, 2013, 8:48 PM), http://dealbook.nytimes.com/2013/11/21/service-members-left-vulnerable-to-payday-loans/?_r=2.

29. *Id.*

30. *Id.*

31. *Id.*

32. *Id.*

33. Wolff, *supra* note 2.

34. *Id.* at 17.

35. *Wall Street Reform: The Dodd-Frank Act*, The White House: President Barack Obama, https://obamawhitehouse.archives.gov/economy/middle-class/dodd-frank-wall-street-reform (last visited Aug. 6, 2017).

36. *Dodd-Frank Wall Street Reform and Consumer Protection Act*, Investopedia, http://www.investopedia.com/terms/d/dodd-frank-financial-regulatory-reform-bill.asp (last visited Aug. 6, 2017).

institutions.[37] In addition to imposing more regulations on the Federal Reserve, banking institutions, and capital markets, the Consumer Financial Protection Bureau created by the Dodd-Frank Act expanded its bank supervision program to nonbanks in efforts to ensure that banks and nonbanks were governed by the same regulations and federal laws.[38] Prior to July 2011, the Consumer Financial Protection Bureau was only regulating large banks and credit unions with assets exceeding 10 billion dollars.[39] With the expansion of the Bureau's supervision program, consumer protection expanded with the oversight of nonbank businesses, mortgage companies, payday lenders, and private education lenders.[40] The Dodd-Frank Act also asserts that the Consumer Financial Protection Bureau may regulate any nonbank that it has reason to believe is engaging, or has engaged, in conduct that poses a risk to consumers.[41]

An addition to the Dodd-Frank Act came with President Obama's signing of the Credit Card Act into law, often referred to as the "Credit Cardholders Bill of Rights."[42] This law has two main objectives: (1) to promote fairness pertaining to prohibiting the increase in interest rates on existing balances, and (2) to promote transparency so that consumers can better understand the cost and terms of their credit cards.[43]

Aside from these recently enacted laws that combat predatory practices, the Federal Trade Commission Act, signed into law in 1914 by President Woodrow Wilson, also provided protection to consumers.[44] Section 5 of the Federal Trade Commission Act, which applies to banks and all persons engaged in commerce, prohibits unfair or deceptive acts or practices that affect commerce.[45] According to the Federal Reserve, an act or practice is unfair when it "causes or is likely to cause substantial injury to consumers[,] cannot be reasonably avoided by consumers[,] and is not outweighed by countervailing benefits to consumers . . . ."[46] Furthermore, the Federal Reserve describes an act or practice as

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37. The White House, *supra* note 35.

38. Steve Antonakes & Peggy Twohig, *The CFPB Launches Its Nonbank Supervision Program*, Consumer Fin. Protection Bureau (Jan. 5, 2012), http://www.consumerfinance.gov/blog/the-cfpb-launches-its-nonbank-supervision-program/.

39. *Id.*

40. *Id.*

41. *Id.*

42. The White House, *supra* note 35.

43. *Id.*

44. Herbert Hovenkamp, *Federal Trade Commission Act (1914)*, Encyclopedia.com, http://www.encyclopedia.com/topic/Federal_Trade_Commission_Act.aspx (last visited Aug. 6, 2017).

45. The Fed. Res., *Federal Trade Commission Act Section 5: Unfair or Deceptive Acts or Practices*, *in* Consumer Compliance Handbook 1 (2008).

46. *Id.*

deceptive "where a representation, omission, or practice misleads or is likely to mislead the consumer."[47]

On the surface, the system that regulates the nation's financial institutions appears to align with consumers' best interests, and more importantly, aligns with the moral integrity that our nation's government has been trying to preserve following the financial crisis of 2008. With every procedural safeguard in place to combat and deter predatory practices, and with all the laws in place to hold parties accountable for their unwarranted actions, the fate of the country's consumers appears promising. But existing legal precedent still does not foreclose the ability of non-national bank entities to charge higher interests rates than what state law permits, which continues to cause harm and disappointment amongst many consumers. This calls into question the future of state consumer laws, despite all the regulatory reform in the United States.

II. National Bank Act of 1864

The lack of a unified banking system in the United States was one of the greatest problems that the nation faced prior to the Civil War, in large part because the state banking system was formed in such a manner that deterred the advancement of a wholly integrated national banking system.[48] As people began to think of themselves as "citizens of a state or a region rather than citizens of the United States," Congress introduced the National Banking Act of 1863 in hopes of creating the first national bank charter, which would provide uniform currency throughout the country.[49] President Abraham Lincoln and members of Congress supported the legislation as an "act of patriotism," and "as a means to assure the future greatness and permanence of the United States."[50] "To oversee the new national [banking] system, Congress created a federal agency within the Department of the Treasury called the Office of the Comptroller of Currency ("OCC")."[51] The National Bank Act gave the OCC the authority to protect national banks from potential intrusive state interference, and implement uniform rules that would apply to all national banks.[52]

Though the intention of the new banking system at that time was to establish unity on a broader scale, the impact of this system had a profound effect not only on the financial market, but also on public

47. *Id.*

48. Off. of the Comptroller of the Currency, U.S. Dep't of the Treas., *A Short History* 1 (2011), http://www.occ.treas.gov/about/what-we-do/history/OCC%20history%20final.pdf.

49. *Id.*; Mark Furletti, *The Debate Over the National Bank Act and the Preemption of State Efforts to Regulate Credit Cards*, 77 Temp. L. Rev. 425, 427 (2004).

50. Off. Of the Comptroller of the Currency, *supra* note 48.

51. Furletti, *supra* note 49, at 3.

52. *Id.*

confidence towards federal laws.[53] Fifty years after the creation of this system, "public dissatisfaction with banking was still keen."[54] Over 150 years later, the National Bank Act of 1864 continues to promote the expansion of our nation's credit industry by allowing nationally chartered financial institutions to conduct business with consumers on a broader scale.[55] One of the fundamental features of the National Bank Act is that it grants nationally chartered banks a wide range of privileges and protections, including the ability to preempt "regulations involving credit card interest rates, fees, and disclosures."[56] Specifically, it permits national banks to "charge on any loan . . . interest at the rate allowed by the laws of the State . . . or District where the bank is located."[57]

The Supremacy Clause of the Constitution establishes that all laws of the United States "shall be the supreme law of the land; and the judges in every state shall be bound thereby."[58] Understanding the meaning of "preemption" derived from the Supremacy Clause of the Constitution is essential to comprehend the dominance of the National Bank Act in the financial market.[59] Preemption is "the principle [] that a federal law can supersede or supplant any inconsistent state law or regulation."[60] Since the National Bank Act preempts analogous state law usury claims, "there is 'no such thing as a state-law claim of usury against a national bank.'"[61] Following the creation of the Dodd-Frank Act, the preemption standards that applied to nationally chartered banks pertaining to state consumer laws were altered.[62] § 25b of Title 12 of the United States Code lays out the blueprint for what would be the new state law preemption standards for national banks.[63] It provides that state consumer financial laws are preempted only if "they would have a discriminatory effect on national banks."[64]

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53. OFF. OF THE COMPTROLLER OF THE CURRENCY, *supra* note 48.

54. "There was a perception that the national system was national in name only, that it favored Eastern, urban interests over Western, rural ones. Moreover, the economy was still subject to periodic bouts of extreme instability, when liquidity and loans dried up and banks failed in alarming numbers." *Id.* at 13.

55. Furletti, *supra* note 49, at 454.

56. *Id.* at 425.

57. *See* 12 U.S.C. § 85 (2012).

58. *See* U.S. CONST. art. VI, cl. 2.

59. *Id.*

60. *Preemption*, BLACK'S LAW DICTIONARY (10th ed. 2014).

61. *Madden*, *supra* note 4, at 250.

62. *See* DEBRA L. HOVATTER, SPILMAN THOMAS & BATTLE, PLLC, PREEMPTION ANALYSIS UNDER THE NATIONAL BANK ACT: THEN AND NOW 13 (2012).

63. *See generally* 12 U.S.C. § 25b (2012).

64. 12 U.S.C. § 25b(b)(1)(A) ("The term 'State consumer financial law' means a State law that does not directly or indirectly discriminate against national banks and that directly and specifically regulates the manner, content, or terms and conditions of any financial transaction (as may be authorized for national banks to engage in), or any account related thereto, with respect to a consumer.") 12 U.S.C. § 25b(a)(2).

Subsection (b), in conjunction with the legal standard set forth in *Barnett Bank v. Nelson,* requires a court to analyze whether affording preemption to non-national bank entities materially impairs the national bank's exercise of its federally created powers.[65] Another fundamental change to the state law preemption standards would go on to affect subsidiaries and affiliates of national banks as well.[66] State consumer financial law applies to a subsidiary or affiliate of a national bank in the same manner that the state consumer financial law applies to any person or entity subject to state law.[67]

Assessing the post-Dodd-Frank Act interpretation of the National Bank Act, the Dodd Frank Act did not resolve the existing issues regarding preemption of consumer protections laws. Instead, the Dodd-Frank Act generated more conflict amongst the financial and legal community in trying to comprehend the scope of the preemption.[68] In trying to define the scope of this preemption, case law has attempted to explain the Act's ambiguities pertaining to state consumer protection laws and their discriminatory effect on national banks' ability to carry out their functions.[69] Looking ahead, this debate will persist because neither the Dodd-Frank Act nor the newly altered National Bank Act have harmonized state and federal laws.[70] While the Dodd-Frank Act changed the way in which courts examine preemption under the National Bank Act, this alteration arguably serves as a stepping stone in the fight towards protecting and enhancing consumers' rights.[71] However, this new standard of examination is just that; the law has not drastically changed, only how the law will be applied.[72]

A. *MADDEN V. MIDLAND FUNDING LLC*

Madden is a unique case because it encompasses the many issues that the National Bank Act raises for an ordinary consumer trying to exercise their rights afforded by state law.[73] In *Madden*, the plaintiff, a resident of New York, opened a credit card account in 2005 with Bank of America, a nationally chartered bank.[74] In the following year, Bank of America's credit card program was consolidated to another national

65. 12 U.S.C. § 25b(1)(B); In *Barnett Bank, N.A. v. Nelson*, the Court held that states could manage national banks when doing so does not prevent or significantly interfere with the national bank's exercise of its powers. 517 U.S. 25 (1996).
66. 12 U.S.C. § 25b(e).
67. *Id.*
68. HOVATTER, *supra* note 62, at 13.
69. *Id.* at 17.
70. *Id.*
71. *Id.* at 22.
72. *Id.*
73. *Madden*, *supra* note 4, at 246.
74. *Id.* at 248.

bank, FIA Card Services ("FIA").[75] Plaintiff owed $5,000 on her credit card account, and in 2008, FIA declared her debt uncollectable.[76] Thereafter, FIA sold plaintiff's debt to defendant Midland Funding LLC ("Midland Funding"), a debt purchaser who is not a nationally chartered bank.[77] When Midland Funding acquired the plaintiff's debt, neither FIA nor Bank of America retained any stake in the account.[78] Later, Midland Credit "sent [plaintiff] a letter seeking to collect payment on her debt and stating that an interest rate of [twenty-seven percent] per year applied."[79]

Plaintiff then initiated a class action lawsuit against Midland Funding alleging that "they had engaged in abusive and unfair debt collection practices in violation of the [Fair Debt Practices Act] FDCPA, [] and had charged a usurious rate of interest in violation of New York law."[80] The district court rendered judgment in favor of Midland Funding, holding that non-national bank assignees are afforded preemption over New York usury laws even if the bank retains no interest or control over the defaulted loans.[81] The district court further noted that charging a higher interest rate than what New York state law allows is permissible so long as the originating bank is entitled to preemption under the National Bank Act.[82]

On appeal, the United States Court of Appeals for the Second Circuit overturned the district court by holding that preemption was not warranted "[b]ecause neither defendant is a national bank nor a subsidiary or agent of a national bank, or is otherwise acting on behalf of a national bank."[83] The Second Circuit justified its holding first, by reasoning that although it is possible for agents to benefit from the National Bank Act, the OCC has made clear that "third-party debt buyers are distinct from agents or subsidiaries of a national bank."[84]

The Second Circuit then concluded that in those instances where National Bank Act preemption has been given to non-national bank entities, the entity exercised powers of a national bank, i.e. "has acted on

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75. *Id.*
76. *Id.*
77. *Id.*
78. *Madden*, *supra* note 4, at 248.
79. *Id.*
80. *Id.* at n.81 (citing 15 U.S.C. §§ 1692e, 1692f (1994); *see also* N.Y. Gen. Bus. Law § 349 (LexisNexis 2014); N.Y. Gen. Oblig. Law § 5-501 (LexisNexis 2011); N.Y. Penal Law § 190.40 (LexisNexis 1976) (proscribing interest from being charged at a rate exceeding twenty-five percent per year).
81. Madden v. Midland Funding, LLC, No. 11-CV-8149 (CS), 2017 U.S. Dist. LEXIS 27109, at *1–2 (S.D.N.Y. Feb. 27, 2017).
82. *Id.* at *2.
83. *Madden*, 786 F.3d at 247.
84. *Id.* at 250; *see also* OFF. OF THE COMPTROLLER OF THE CURRENCY, OCC. BULL. 2014–37, RISK MANAGEMENT GUIDANCE (2014).

behalf of a national bank in carrying out the national bank's business."[85] Ultimately, preemption could not be granted because Midland Funding did not "act on behalf of [Bank of America] or FIA in attempting to collect on [plaintiff's] debt," but instead acted "solely on their own behalves, as the owners of the debt."[86] Finally, the Second Circuit applied the *Barnett* standard set forth in the new preemption standards of the National Bank Act.[87] Following *Barnett*, the court reasoned that applying state usury laws to Midland Funding would not adversely interfere with Bank of America's or FIA's ability to exercise its national bank privileges.[88]

On November 10, 2015, Midland Funding LLC petitioned the Supreme Court to review the Second Circuit's decision in *Madden,* urging the Court to overturn the holding on the grounds that the decision conflicted with circuit precedent "and years of contrary Supreme Court precedent providing broad protection under the [National Bank Act]."[89] On June 27, 2016, the petition for certiorari was denied.[90]

B. Circuit Splits

Though the Second Circuit held in plaintiff's favor in *Madden*, there exists a circuit split with respect to allowing non-national bank entities preemption over state usury consumer laws.[91] In *Madden v. Midland Funding, LLC*, the defendants relied on two Eighth Circuit cases which held that National Bank Act preemption "precluded state law usury claims against non-national bank entities."[92] In *Krispin v. May Department Stores*, the plaintiff initiated a lawsuit against May Department Stores Company ("May Stores"), a non-nationally chartered bank, after it charged plaintiff fifteen dollars in delinquency fees, which was over the Missouri law limit of ten dollars.[93] The accounts were then transferred to May National Bank of Arizona ("May Bank") where the bank charged delinquency fees of fifteen dollars.[94]

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85. *Madden*, 786 F.3d at 251.
86. *Id.*
87. *Id.*
88. *Id.*
89. Jennifer L. Gray, *Midland Credit Seeks SCOTUS Review of 2d Circuit Ruling That Significantly Impairs National Banks' Ability to Sell Loans at Note Rate*, LEXOLOGY (Nov. 25, 2015) http://www.lexology.com/library/detail.aspx?g=1d84e558-cef5-4dd6-8c4f-f7dcf167a58c.
90. *Midland Funding, LLC v. Madden*, SCOTUS BLOG, http://www.scotusblog.com/case-files/cases/midland-funding-llc-v-madden/ (last visited Aug. 6, 2017).
91. *See* Krispin v. May Dep't Stores Co., 218 F.3d 919 (8th Cir. 2000); Phipps v. FDIC, 417 F.3d 1006 (8th Cir. 2005).
92. *Madden*, 786 F.3d at 252.
93. *Krispin*, 218 F.3d at 921.
94. *Id.* at 922.

Though May Stores transferred authority of the terms and operations of said accounts to May Bank, it subsequently purchased the bank's receivables and retained a role in the account collection.[95] The court reasoned that "the store's purchase of the bank's receivables does not diminish the fact that it is now the bank, and not the store, that issues credit, processes and services customer accounts, and sets such terms as interest and late fees."[96] The court recognized that although the National Bank Act only applies to national banks, it concluded that in circumstances such as this one, "it makes sense to look to the originating entity (the bank), and not the ongoing assignee (the store), in determining whether the [National Bank Act] applies."[97]

In *Federal Deposit Insurance v. Lattimore Land Corporation,* the Fifth Circuit held that the legal character of a note should not change when there has been a change in ownership.[98] There, in October 1975, Hamilton Mortgage assigned a note with 91.48% interest to Hamilton National Bank.[99] After encountering financial difficulties, the Comptroller of the Currency declared Hamilton National Bank to be insolvent in February 1976.[100] The United States District Court thereafter authorized the FDIC to purchase certain of the Bank's assets, one of which was the 91.48% interest in the present note.[101] In March 1978, the FDIC demanded payment of the note from defendant, Lattimore Land.[102] The district court granted judgment in favor of FDIC for the principal amount and $830,348.96 in interest.[103] On appeal, the defendants argued that the 91.48% interest charged by Hamilton National Bank was usurious.[104] In addition, the defendants further contended that "allowable interest was controlled by Tennessee's ten percent maximum rate after the bank received the interest in the note."[105]

In *Lattimore*, Fifth Circuit recognized that the National Bank Act allows national banks to charge interest rates permitted in the state where the bank is located, in this instance, Georgia.[106] The court also noted that the National Bank Act applies "to interstate loans made by national banks doing business with residents of states with lower

95. *Id.* at 923.
96. *Id.* at 941.
97. *Id.* at 924.
98. FDIC, *supra* note 3, at 148–49.
99. *Id.* at 141.
100. *Id.*
101. *Id.*
102. *Id.*
103. *Id.*
104. FDIC, *supra* note 3, at 146.
105. *Id.*
106. *Id.* at 147.

permissible levels of interest."[107] Moreover, neither the plaintiffs nor the defendants contended that interest was usurious under Georgia law.[108] The court ultimately held that Georgia usury laws governed the interest on the note and that Tennessee's usury law did not apply because the "non-usurious character of a note should not change when the note changes hands."[109] For this reason, the FDIC was allowed to collect on the interest owed.[110]

Finally, in *Olvera v. Blitt & Gaines*, the Seventh Circuit held that an assignee of debt is free to charge the same interest rate that the original creditor charged the debtor even if the assignee did not have a license that expressly permitted the charging of the higher interest rate.[111] The court indicated that adopting plaintiff's interpretation of the Illinois Interest Act would be detrimental to national banks because it would wipe out the debt purchaser market and thus force national banks to conduct their own debt collection.[112]

III. Analysis: Solving the Problem & Proving the Thesis

The Dodd-Frank Act recognizes that courts should give deference to state laws for activities that are undertaken by subsidiaries or non-national bank entities.[113] However, not every consumer who seeks damages through the Dodd-Frank Act provisions is successful. The problem lies within the law itself. When Congress enacted the Dodd-Frank Act and made changes to the National Bank Act, these new provisions were intended to be non-retroactive.[114] A retroactive law is not unconstitutional unless it is an ex post facto law, meaning that the new law "negatively affects a person's rights as by making into a crime an action that was legal when it was committed."[115]

Furthermore, the Dodd-Frank Act stipulates that the Act should not be construed in such a manner as to alter or affect the application of any regulation under state or federal banking law to any contract entered into on or before July 21, 2010—the date of Dodd-Frank Act's enactment—by national banks or subsidiaries. [116] To comply with the non-retroactive provision, courts have chosen to enforce contracts

107. *Id.*
108. *Id.* at 146.
109. *Id.* at 148–49.
110. FDIC, 656 F.2d at 150.
111. *See* Olvera v. Blitt & Gaines, P.C., 431 F.3d 285 (7th Cir. 2005).
112. *Id.* at 288.
113. *See generally* 12 U.S.C. § 25b(e) (2012).
114. 12 U.S.C. § 5553 (2012).
115. *Ex post facto law*, Black's Law Dictionary (10th ed. 2014).
116. 12 U.S.C. § 5553.

entered into before July 21, 2010.[117] The effect of this provision, in essence, allows a party who committed acts that would otherwise be deemed unlawful post-Dodd-Frank Act to escape liability and suffer no consequences as a result.[118] Accordingly, abusive contracts that were entered into during the financial crises between consumers and financial institutions would still be deemed enforceable, whether or not the accounts in question were assigned to non-chartered bank entities.[119]

Since courts cannot rely on Dodd-Frank Act policy considerations in formulating their opinion on contracts entered into before July 2010, courts instead must address this issue on different grounds, such as whether the non-national bank entity was acting on behalf of the national bank during the course of business with consumers, as seen in *Madden*.[120] Other circuits have addressed the issue using a less rigorous, pro-industry standard, which suggests that one must only look at the originating entity (the bank) and not the ongoing assignee in determining whether the National Bank Act applies.[121]

Circuit splits of this nature are a cause for concern for many consumers because they illustrate that although said practices are no longer allowed under the Dodd-Frank Act, circuit precedent is picking a winner and loser depending on which jurisdiction a citizen resides. Should the Supreme Court overturn the Second Circuit *Madden* decision in the near or distant future, then consumers who entered into abusive contracts with national banks prior to the Dodd-Frank Act would be unable to rely on existing precedent because it suggests that said collection practices are in fact lawful when conducted by non-national bank entities.

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117. *See* Molosky v. Washington Mutual, Inc., 664 F.3d 109 (6th Cir. 2011) (recognizing that the Dodd-Frank Act has changed the type of preemption available under the Home Owners Loan Act ("HOLA"). HOLA, applying HOLA field preemption standards to bar plaintiffs' claim of usurious prepayment fees because Dodd-Frank Act was not intended to be retroactive); Brown v. Wells Fargo, N.A., 869 F. Supp. 2d 51, 56 n. 5 (D.D.C. 2012) (noting that preemption landscape with respect to federal savings banks was "altered significantly" by Dodd-Frank, holding that the new preemption standards did not apply because the Act was passed after plaintiff received the loan at issue, and, therefore, several of borrower's claims under DC Consumer Protection Procedures Act were preempted by HOLA, 12 C.F.R. § 560.2 (2013)); Sovereign Bank v. Sturgis, 863 F. Supp. 2d 75, 92 (D. Mass. 2012) (because Dodd-Frank Act does not apply retroactively, claims against federally chartered bank for failure to provide proper disclosures under state law held preempted by HOLA, pursuant to 12 C.F.R. § 560.2(b)); Benford v. CitiMortgage, Inc., No. 11-12200, 2011 WL 5525942 (E.D. Mich. Nov. 14, 2011) (dismissing claim against subsidiary of national bank as preempted under rule of Watters v. Wachovia Bank. Dodd-Frank's change to preemption rules of subsidiaries did not go into effect until after events of the case).

118. *See* Krispin v. May Dep't. Stores, 218 F.3d 919, 921(8th Cir. 2000).

119. *See Benford*, 2011 WL 5525942 (dismissing claim against subsidiary of national bank as preempted under rule of *Watters v. Wachovia Bank*).

120. *Madden*, *supra* note 4, at 246.

121. *See Krispin*, 218 F.3d 919; Phipps v. FDIC, 417 F.3d 1006 (8th Cir. 2005).

A. Proposal: Combatting the Sale of Contracts to Non-National Banks Who Engage in Predatory Practices.

The *Madden* decision has far-reaching implications. It has long been established that a state usury cause of action against a nationally charted bank is almost impossible to adjudicate successfully because "there is no such thing as a state-law claim of usury against a national bank." Accordingly, in the event the Supreme Court does decide to address the existing circuit splits, the Supreme Court should uphold the *Madden* decision.[122] Conversely, if the Supreme Court decides not to hear the case, the remaining twelve circuits should emulate the Second Circuit's decision in *Madden*.

If the Supreme Court ever grants certiorari, it is critical that the Court affirm the holding reached in *Madden*. Although the Dodd-Frank Act and subsequent regulations are in place to ensure consumers receive protection from hidden fees, abusive terms, and deceptive practices, these laws do not provide consumers with the ability to recover damages for harms suffered prior to the Dodd-Frank Act.[123] To date, the Fifth, Seventh, and Eight Circuit Courts have continuously upheld the prevailing view that whether the National Bank Act preempts the application of state usury law depends on which entity originated the loan in question.[124] Not only are consumers unable to exercise the application of state consumer laws, it won't be until the Supreme Court upholds the *Madden* decision that consumers in all jurisdictions will finally have legal recourse to combat and recover against predatory practices.

Legal recourse serves a dual purpose. Aside from being able to combat unfair predatory practices, a binding decision would have a deterrent effect on non-national bank entities that wish to engage in this type of prohibited conduct; now these entities will be put on notice that such practices are no longer prohibited only in certain jurisdictions, but also prohibited nationwide. Since the law in all fifty states will be pro-consumer, a non-national bank entity that wishes to charge interest rates in excess of state usury caps will no longer be enticed to conduct business in a jurisdiction that has determined that these practices are no longer tolerated. Currently, despite the Second Circuit's holding in *Madden*, any non-national bank entity still has the ability to collect on contracts that were entered into prior to 2011 outside the Second Circuit. Above all, should the Supreme Court ever decide to uphold *Madden,* the Court's

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122. *Madden*, 786 F.3d at 250 (quoting Beneficial Nat'l Bank v. Anderson, 539 U.S. 1, 11 (2003)).

123. *See generally* 12 U.S.C. § 5553 (2012).

124. *See Krispin*, 218 F.3d 919; *Phipps*, 417 F.3d 1006; Olvera v. Blitt & Gaines, P.C., 431 F.3d 285 (7th Cir. 2005); *see also* FDIC, *supra* note 3.

decision will preserve the underlying dynamics for what this new financial regulatory reform stands for: consumer protection.

Consequently, what remains is a circuit split that will continue to create uncertainty in the lending industry, which could ultimately prompt the Supreme Court to step in. The Valid-When-Made Doctrine has given non-national bank institutions the ability to receive loans that were originated by national banks in a manner that would remain non-usurious after the assignment.[125] Although the Second Circuit did not discuss the Valid-When-Made Doctrine, "the Valid-When-Made Doctrine compels the conclusion that loans that are valid when originated remain valid after assignment, even if the [National Bank Act] preemption does not apply."[126] Therefore, practitioners suggest that any party "arguing against the application of *Madden* . . . should emphasize the Valid-When-Made-Doctrine."[127] Though *Madden* is merely persuasive to other circuit courts, in order to undermine the Valid When Made Doctrine offered by defendants outside the Second Circuit, it is equally important that remaining circuit courts begin to follow *Madden.*

An increasingly fractured jurisprudence at the circuit court level may ultimately pressure the Supreme Court to address splits that continue to affect consumers and financial institutions. If the Supreme Court does address the circuit splits in this manner, then the Court could halt reliance on the Valid When Made Doctrine to enforce loan agreements that contain terms that violate consumers' rights under state law. By doing so, these non-bank entities will no longer be afforded the same interest rate authority as national banks.

B. Counter Arguments

National banks will likely contend that not affording these entities and assignees preemption over state consumer usury laws will significantly interfere with the way nationally chartered banks conduct their business and also interfere with the way national banks exercise their privileges. In retrospect, this goes against the new *Barnett* standard found in the clarified National Bank Act. However, this argument is ill-founded provided there is no detrimental effect in not granting these entities preemption over state usury laws. The worst-case scenario is that national banks will no longer be able to sell defaulted debt to assignees and non-bank entities. Requiring national banks to collect on their defaulted loans does not impair their ability to exercise federal privileges

125. *See Lattimore*, 656 F.2d 139.

126. Deborah Festa et. al., *United States: Madden v. Midland Funding LLC—Implications and Potential Responses*, Mondaq (Oct. 15, 2015), http://www.mondaq.com/unitedstates/x/435110/Financial+Services/Madden+v+Midland+Funding+LLC.

127. *Id.*

such that they will still be preempted from state usury laws. Moreover, the fact that non-national bank entities will no longer be willing to purchase the defaulted debt from national banks because they are no longer allowed to charge the same interest rate as these banks also does not impede a national bank's exercise of its federal authority as suggested in *Barnett*.

Accordingly, it is important to point out that when Congress created the National Bank Act, it was the legislators' intent to grant national banks preemption over state usury laws, as this was the only way to create an integrated national market.[128] Extending preemption to non-national bank entities was never on the agenda or even part of the plan to create this unified banking system.[129] If legislators in 1863 and the post-Dodd-Frank Act era intended to have done so, they would have included it within the statutory text. Still, as evidenced by the newly enacted Dodd-Frank Act provisions, not even subsidiaries, affiliates, or agents of national banks are granted preemption over state usury laws; thus, there is no reason to extend this preemption to non-national bank entities and assignees of national banks.[130]

Less regulation on certain enterprises in certain situations is at times the best way to achieve favorable outcomes for consumers. Industry groups may argue that not affording these entities preemption is anti-capitalistic, however, this Note emphasizes the opposite. The National Bank Act does not allow the free markets to function—the National Bank Act is protecting financial institutions that engage in risky behavior by allowing them to divest of their risky investments. This Second Circuit ruling can create an equilibrium in the capital markets that will be good for both financial institutions and consumers. Financial institutions will be rewarded for making sound lending decisions, and those that engage in reckless lending practices will be punished in the vein of the 2008 financial crisis. Consumers will benefit because this ruling has the ability to give all fifty states the rights to figure out what works best for their economy. Each state having their own state consumer laws that regulate non-national bank entities in all facets of the financial market will in essence create more competition amongst these entities. Therefore, since these subsidiaries, agents, and assignees will no longer be protected, interest rates will begin to decrease. Ultimately this could enhance liquidity in the market, and give non-national bank entities the ability to tailor lending practices to state laws by providing the consumer the best loan product available for each level of credit. This effect can therefore restore consumers' faith in the financial system,

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128. *See generally* Off. of the Comptroller of the Currency, *supra* note 48.
129. *See generally id.*
130. *See* 12 U.S.C. § 25b(e) (2012).

all while creating increased levels of participation in the financing market.

Conclusion

Consumers' right can be salvaged if the judicial branch takes the proper steps moving forward. Congress has recognized the detrimental consequences of predatory lending and its destructive effect and passed legislation that outlawed those practices going forward. However, that legislation does not grant relief to the people who entered into unfair contracts with banks prior to the enactment of the Dodd-Frank Act. If the Supreme Court were to ever uphold *Madden*, then consumers who entered into unfair contracts prior to the enactment of the Dodd-Frank Act could seek justice through the application of their state consumer usury law protections. But, for purposes of continuing the fight against predatory practices for consumers throughout the nation, the remaining circuit courts must begin to follow Second Circuit precedent.

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